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UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF CALIFORNIA

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

In re: ) Case No. 14-25820-D-11  
INTERNATIONAL MANUFACTURING )  
GROUP, INC., )  
Debtor. )

BEVERLY N. McFARLAND, ) Adv. Pro. No. 15-2130-D  
Chapter 11 Trustee, )  
Plaintiff, ) Docket Control No. JRD-1

v. )  
GENERAL ELECTRIC CAPITAL ) DATE: September 9, 2015  
CORPORATION, ) TIME: 10:00 a.m.  
Defendant. ) DEPT: D

MEMORANDUM DECISION

This is the motion of defendant General Electric Capital Corporation ("GECC") to dismiss the complaint of the plaintiff, Beverly McFarland, who is also the trustee in the chapter 11 case in which this adversary proceeding is pending (the "trustee"), pursuant to Fed. R. Civ. P. 9(b) and 12(b)(1), made applicable in this proceeding by Fed. R. Bankr. P. 7009 and 7012(b), for failure to plead fraud with particularity and failure to state a claim upon which relief can be granted. The plaintiff has filed opposition, GECC has filed a reply, and the court has heard oral argument. For the following reasons, the motion will be denied.

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1 In ruling on a Rule 12(b)(6) motion, a court "accept[s] as  
2 true all facts alleged in the complaint, and draw[s] all  
3 reasonable inferences in favor of the plaintiff." al-Kidd v.  
4 Ashcroft, 580 F.3d 949, 956 (9th Cir. 2009), citing Newcal  
5 Indus., Inc. v. Ikon Office Solution, 513 F.3d 1038, 1043 n.2  
6 (9th Cir. 2008). The court assesses whether the complaint  
7 contains "sufficient factual matter, accepted as true, to 'state  
8 a claim to relief that is plausible on its face.'" al-Kidd, 580  
9 F.3d at 949, citing Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949,  
10 (2009), in turn quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544,  
11 570 (2007).

12 By her complaint, the trustee seeks to avoid four transfers  
13 of \$500,000 each made by an entity named Olivehurst Glove  
14 Manufacturers, LLC ("Olivehurst") to GECC as actual fraudulent  
15 conveyances, pursuant to § 548(a)(1)(A) of the Bankruptcy Code,<sup>1</sup>  
16 and to recover the value of the transfers from GECC, pursuant to  
17 § 550. The transfers were made within the year prior to the  
18 filing of the chapter 11 petition of International Manufacturing  
19 Group, Inc. ("IMG"), the debtor in the case in which this  
20 adversary proceeding is pending. Olivehurst has been  
21 substantively consolidated into IMG's bankruptcy estate. GECC  
22 makes five arguments in support of its contention that the  
23 complaint fails to state a claim upon which relief can be

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27 1. Unless otherwise indicated, all statutory references are  
28 to the United States Bankruptcy Code, Title 11, United States  
Code.

1 granted. The court will take them in the order presented by  
2 GECC.<sup>2</sup>

3 **I. The Fraudulent Transfer Versus Preference Issue**

4 First, GECC contends the trustee's claim is a preference  
5 claim, not a fraudulent transfer claim, and that, as a preference  
6 claim, it is time-barred because all of the transfers were made  
7 more than 90 days before the date IMG filed its petition, May 30,  
8 2014. There is no dispute that the transfers were made outside  
9 the 90-day period, and therefore cannot be recovered as  
10 preferences. The question is whether, even if they could have  
11 been recovered as preferences if they had been made within the 90  
12 days, they might be fraudulent transfers as well. GECC cites  
13 Boston Trading Group, Inc. v. Burnazos, 835 F.2d 1504 (1st Cir.  
14 1987), for the proposition that "fraudulent transfer laws cannot  
15 be used to recover payments to legitimate lenders where the  
16 transferee engaged in fraud to raise the money used to repay the  
17 lender." GECC's Motion, filed July 24, 2015 ("Mot."), at  
18 10:15-17.

19 In Boston Trading, a court-appointed receiver for a company  
20 that managed the funds of commodities investors sought to recover  
21 as actual fraudulent conveyances payments made by the company's  
22 owners, Shaw and Kepreos, from the company's funds, to the  
23 individual who had sold them the company, Burnazos, toward the  
24 purchase price. The evidence showed that Shaw and Kepreos had  
25 been churning investors' accounts by making unnecessary trades in  
26

27  
28 2. GECC's contention that the complaint fails to state  
fraud with particularity is woven throughout the motion, not  
separately treated; the court addresses it in like fashion.

1 order to generate commissions; the receiver alleged Burnazos knew  
2 or should have known about their dishonest activity.

3       The court held that where an individual uses his  
4 corporation's money, which he obtained dishonestly, to pay his  
5 debt to a creditor "who knows of, but did not participate in,  
6 [the] dishonesty," the payment is not recoverable as an actual  
7 fraudulent conveyance. 835 F.2d at 1510. The court's discussion  
8 and holding both strongly suggest the court believed that a  
9 preference, which the payments to Burnazos clearly were, cannot  
10 also be a fraudulent transfer. The court made this blanket  
11 statement: "The cases and the commentators . . . state that  
12 fraudulent conveyance law does not seek to void transfers in a .  
13 . . circumstance known as a 'preference.'" Id. In explanation,  
14 the court stated that the purpose of the fraudulent transfer laws  
15 is not to achieve an equal distribution among creditors (id. at  
16 1508-09), but "to see that the debtor uses his limited assets to  
17 satisfy some of his creditors . . . ." Id. at 1509. The court  
18 added that "to find an actual intent to defraud creditors when .  
19 . . an insolvent debtor prefers a less worthy creditor, would  
20 tend to deflect fraudulent conveyance law from one of its basic  
21 functions (to see that an insolvent debtor's limited funds are  
22 used to pay some worthy creditor), while providing it with a new  
23 function (determining which creditor is the more worthy)." Id.

24       In short, the Boston Trading court came very close to  
25 holding, if it did not actually do so, that a transfer that would  
26 constitute a preference if made within the preference period  
27 cannot also be an actual fraudulent conveyance. However, the  
28 court did not also find that a preference cannot be a

1 constructive fraudulent conveyance. Instead, it remanded for a  
2 retrial on the issue of whether Burnazos gave a "fair equivalent"  
3 in exchange for the payments. 835 F.2d at 1513-14. The court  
4 did hold, as to the "good faith" defense to a constructive  
5 fraudulent transfer claim, that lack of good faith cannot be  
6 found from the mere fact that the creditor received a preference,  
7 even where the creditor knew the payment was made with improperly  
8 obtained funds. Id. at 1511-12.

9        Whatever "good faith" may mean . . . we believe it does  
10       not ordinarily refer to the transferee's knowledge of  
11       the source of the debtor's monies which the debtor  
12       obtained at the expense of other creditors. To find a  
13       lack of "good faith" where the transferee does not  
14       participate in, but only knows that the debtor created  
15       the other debt through some form of, dishonesty is to  
16       void the transaction because it amounts to a kind of  
17       'preference' - concededly a most undesirable kind of  
18       preference, one in which the claims of alternative  
19       creditors differ considerably in their moral worth, but  
20       a kind of preference nonetheless. And all the reasons  
21       that militate against finding a § 7 violation ('actual  
22       fraud') in such circumstances . . . militate with at  
23       least equal force against finding a § 4 violation  
24       ('constructive fraud').

25       Id. at 1512 (citations omitted).<sup>3</sup>

26       GECC's reliance on Boston Trading is not persuasive in this  
27       case for several reasons. First, as the trustee points out, the  
28       case involved only state fraudulent transfer law (in particular,  
29       the law of Massachusetts); the cases the court cited in support  
30       of its conclusion that a preference cannot also be an actual  
31       fraudulent conveyance involved only state law, not § 548 of the  
32       Bankruptcy Code. GECC's only response on this point is to note  
33       that "Section 548 is based on the Uniform Fraudulent Conveyance

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34       3. As discussed below, this analysis of the good faith  
35       standard appears to be contrary to Ninth Circuit law.

1 Act" (GECC's Reply, filed Sept. 2, 2015 ("Reply"), at 4:25), on  
2 which the state fraudulent transfer laws are also based. The  
3 answer is too pat. Although the state and federal statutes are  
4 "similar in form and substance" (In re United Energy Corp., 944  
5 F.2d 589, 594 (9th Cir. 1991)), they are not identical. See  
6 Plotkin v. Pomona Valley Imports (In re Cohen), 199 B.R. 709, 712  
7 (9th Cir. BAP 1996) ["The differences between the fraudulent  
8 transfer provisions in the Bankruptcy Code and the Uniform  
9 Fraudulent Transfer Act are central to this appeal."]; see also  
10 Jobin v. McKay (In re M & L Bus. Mach. Co.), 84 F.3d 1330, 1338  
11 (10th Cir. 1996) ["[W]e are not persuaded . . . that the  
12 definitions of good faith under . . . state fraudulent conveyance  
13 laws should be adopted in interpreting § 548(c). Many of these  
14 provisions contain language different than the language used in §  
15 548(c) and . . . involve policy concerns not applicable here."].

16 Second, as the trustee points out, the statutory language  
17 itself strongly suggests that a transfer may be avoidable as both  
18 a preference and a fraudulent transfer under federal bankruptcy  
19 law. The Bankruptcy Code provides: "Except to the extent that a  
20 transfer . . . voidable under this section is voidable under  
21 section . . . 547 of this title," a transferee that takes for  
22 value and in good faith may retain the property transferred. §  
23 548(c) (emphasis added). Were preferences and fraudulent  
24 transfers mutually exclusive, this language would be meaningless.

25 Third, as the trustee also points out, if preferences and  
26 fraudulent transfers were mutually exclusive, trustees in Ponzi  
27 scheme cases would be unable to recover payments made to earlier  
28 investors at the expense of later ones except those made in the

1 90-day preference period. Yet "[c]ourts have routinely applied  
2 [state fraudulent transfer law] to allow receivers or trustees in  
3 bankruptcy to recover monies lost by Ponzi scheme investors. The  
4 Ponzi scheme operator is the 'debtor,' and each investor is a  
5 'creditor.' The profiting investors are the recipients of the  
6 Ponzi scheme operator's fraudulent transfer." Donell v. Kowell,  
7 533 F.3d 762, 767 (9th Cir. 2008) (citations omitted). "The  
8 policy justification is ratable distribution of remaining assets  
9 among all the defrauded investors." Id. at 770.<sup>4</sup> As the trustee  
10 puts it, "[i]f creditor status were enough to immunize a transfer  
11 from section 548 avoidance by magically transforming it into a  
12 preference, then a trustee could never avoid transfers made as  
13 return of principal under section 548" (Trustee's Opposition,  
14 filed Aug. 26, 2015, at 16:20-17:1), which trustees can do in  
15 cases of actual fraudulent transfers to transferees not acting in  
16 good faith. Id. at 771 ["Under the actual fraud theory, the  
17 receiver may recover the entire amount paid to the winning  
18 investor, including amounts which could be considered 'return of  
19 principal.' However, there is a 'good faith' defense that  
20 permits an innocent winning investor to retain funds up to the  
21 amount of the initial outlay."].

22 Fourth, a close analysis of Boston Trading reveals that it  
23 does not stand for the proposition for which GECC cites it. As  
24 stated in its reply, GECC cites the case as "establish[ing] that  
25 fraudulent transfer claims do not lie against legitimate  
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27 4. This latter statement blunts GECC's insistence on the  
28 differing purposes behind preference and fraudulent conveyance  
law as decisive.

1 creditors receiving payment on legitimate debt, even where the  
2 transferee may have had reason to suspect the source of the funds  
3 and knew that the transferor was a fraudster." Reply at 3:16-18.  
4 Where GECC goes wrong is in focusing on the status, knowledge,  
5 and behavior of the transferee - as, for example, a "legitimate  
6 creditor receiving payment on legitimate debt" and the  
7 transferee's knowledge "that the transferor was a fraudster,"  
8 whereas for purposes of an actual fraudulent conveyance, the  
9 initial focus is on the transferor and only the transferor. That  
10 is, the first question the court must decide is whether the  
11 transferor made the transfer "with actual intent to hinder,  
12 delay, or defraud" his or her creditors. § 548(a)(1)(A). There  
13 is nothing in the statute to suggest that a payment on a  
14 legitimate debt to a legitimate creditor cannot be an actual  
15 fraudulent conveyance if it was made with the actual intent on  
16 the part of the transferor to hinder, delay, or defraud his or  
17 her creditors.

18 This is where GECC departs from the actual holding in Boston  
19 Trading; that is, the holding as applied to the facts in the  
20 case, as opposed to the court's general conclusions about  
21 fraudulent transfers and preferences. The court acknowledged  
22 that the Massachusetts statute it was considering "makes  
23 'fraudulent' every transfer made 'with actual intent' (as opposed  
24 to 'intent presumed in law') to 'hinder, delay or defraud . . .  
25 creditors.'" Boston Trading, 835 F.2d at 1510. The court then  
26 held, with regard to the specific facts in the case:



1 In effect, the Receiver argues that Shaw and Kepreos  
2 took the \$ 473,000 from BTG by fraud (or other  
dishonest means) and paid it to Burnazos who had full  
knowledge of their dishonesty.

3 We rephrase the legal question slightly both to reflect  
4 the evidence and to avoid the potentially confusing  
coincidence that we are dealing with a form of initial  
5 dishonesty (i.e., the 'churning' of accounts by Shaw  
and Kepreos) that itself happens to be called fraud.  
6 Suppose that S & K, officers of Corporation C, obtain  
C's money through dishonest means (larceny, fraud,  
7 etc.) and use it to pay a debt that S & K owe B, a  
transferee who knows of, but did not participate in, S  
8 & K's dishonesty. Does [the Massachusetts actual  
fraudulent transfer statute] permit C to recover its  
9 money from B? We think the district court correctly  
ruled that [it] does not.

10 First, we have found no modern case . . . that has  
11 found a fraudulent conveyance in such circumstances.  
That is not surprising, for the fraud or dishonesty in  
12 this example concerns not S & K's transfer to B, but  
the manner in which the original debt to C arose.  
13 Fraudulent conveyance law is basically concerned with  
transfers that 'hinder, delay or defraud' creditors; it  
14 is not ordinarily concerned with how such debts were  
created.

15  
16 Id. (first emphasis added). In other words, the court found no  
17 actual intent to defraud in the transfer the receiver was  
18 challenging, only in the manner in which the transferors had  
19 acquired the money in the first place.

20 The court later referred to the facts before it, "where the  
21 only fraud concerns the source of the funds transferred" (id. at  
22 1513 (emphasis in original)), and concluded that "the only  
23 'fraud' shown in respect to Shaw and Kepreos concerns the source  
24 of the debt to NIS, not the transfer to Burnazos. That kind of  
25 fraud - dishonesty in the creation of the debt - is (in the  
26 circumstances present here) not the kind of fraud that the  
27 [Massachusetts actual fraudulent transfer statute] addresses."  
28 Id. at 1517 (emphasis in original). In other words, the only

1 fraud the court found was in the way the transferors had acquired  
2 the money they transferred to the transferee; there was no  
3 evidence the transferors made the transfer - the one challenged  
4 by the receiver - with the actual intent to hinder, delay, or  
5 defraud creditors. The case simply does not support the  
6 conclusion GECC draws from it - that regardless of the  
7 transferor's intent in making the challenged transfers, "where,  
8 as here, the transfers at issue are used to pay a legitimate  
9 creditor a legitimate debt those transfers are not 'voidable' in  
10 the first instance . . . ." Reply at 3:13-15.

11 GECC fares no better with the second case it cites, although  
12 the facts appear at first glance more similar to those in this  
13 case. Sharp Int'l Corp. v. State St. Bank & Trust Co. (In re  
14 Sharp Int'l Corp.), 403 F.3d 43 (2nd Cir. 2005), involved a  
15 debtor company that "was looted by its controlling shareholders."  
16 403 F.3d at 46. The bankruptcy trustee then sued, under New York  
17 fraudulent transfer law, one of the debtor's lenders, State  
18 Street Bank, "which suspected the fraud and extricated itself in  
19 a way that, according to [the trustee], facilitated the  
20 victimization of other lenders and the continued looting of [the  
21 debtor] itself." Id. The bankruptcy court dismissed the  
22 trustee's complaint on a Rule 12(b)(6) motion; the district court  
23 affirmed, holding, with respect to the trustee's actual  
24 fraudulent transfer claims, that the trustee, although he had  
25 alleged actual knowledge of the fraud on the part of State  
26 Street, "had not alleged that State Street 'participated in' or  
27 'induced' the [controlling shareholders'] fraud." Id. at 49.

28 / / /

1       The factual allegations in Sharp Int'l are similar to those  
2 in the present case. In that case, the controlling shareholders  
3 "falsified sales, inventory, and accounts receivable, and  
4 invented customers, in order to report fictitious revenue on [the  
5 company's] nonpublic financial records" (403 F.3d at 46),  
6 fraudulently reporting that its sales were much higher than they  
7 were, thus enabling the shareholders to borrow more and more  
8 money, which they then diverted to themselves. After its loans  
9 were made, State Street began to suspect problems from the  
10 company's "refusal to comply with accounting procedures required  
11 under the [parties'] loan agreement," its "fast growth and  
12 voracious consumption of cash" (id. at 47), and State Street's  
13 responsible officer's experience with a fraud at another company.  
14 State Street hired both outside counsel and a financial  
15 investigation firm to conduct a formal investigation. It also  
16 asked for more information about the company's customers, asked  
17 to see its outside auditor's work papers, requested formal  
18 confirmation of accounts receivable, reviewed checks for insider  
19 payments, and reviewed Dun & Bradstreet reports on several of the  
20 company's customers. When this information was either refused or  
21 turned up yet more suspicious circumstances, the trustee alleged,  
22 State Street "arranged quietly for [the shareholders] to repay  
23 the State Street loan from the proceeds of new loans from  
24 unsuspecting creditors . . . ." Id.

25       The court of appeals found these allegations insufficient to  
26 support a claim against State Street for aiding and abetting  
27 breaches of fiduciary duty because they did not sufficiently  
28 allege that State Street knowingly induced or participated in the

1 fraud. 403 F.3d at 50. Although it assumed for purposes of its  
2 decision that "State Street knew about the looting as well as  
3 about the use of phony books and records to obtain loans" (id.),  
4 the court found that "the complaint says no more than that State  
5 Street relied on its own wits and resources to extricate itself  
6 from peril, without warning persons it had no duty to warn." Id.  
7 at 51. As to the actual fraudulent conveyance claim, however,  
8 the focus was, as in Boston Trading, on the absence of fraud in  
9 the particular transfer the trustee sought to avoid. The court  
10 held that the claim "fails for the . . . reason that [the  
11 trustee] inadequately alleges fraud with respect to the  
12 transaction that [he] seeks to void, i.e., [the debtor's] \$ 12.25  
13 million payment to State Street." Sharp Int'l, 403 F.3d at 56,  
14 citing Boston Trading, 835 F.2d at 1510, for the proposition that  
15 "[f]raudulent conveyance law is basically concerned with  
16 transfers that 'hinder, delay or defraud' creditors; it is not  
17 ordinarily concerned with how such debts were created." "The  
18 fraud alleged in the complaint relates to the manner in which  
19 [the debtor] obtained new funding from the Noteholders, not [the  
20 debtor's] subsequent payment of part of the proceeds to State  
21 Street." Sharp Int'l, 403 F.3d at 56.

22 In contrast, in the present case, the complaint contains  
23 detailed allegations that, taken as true, would support a finding  
24 that the transfers to GECC were made with the actual intent on  
25 the part of the transferor to hinder, delay, or defraud  
26  
27  
28

1 creditors.<sup>5</sup> The complaint alleges, first, that each of the  
2 transfers was made in furtherance of the Ponzi scheme in that, by  
3 causing the transfers to be made, its mastermind, Deepal  
4 Wannakuwatte, "hoped to appease GECC, thereby prolonging the  
5 duration of the fraudulent scheme by: (a) avoiding any adverse  
6 final judgment or findings of fact in litigation; (b) preventing  
7 knowledge of his various fraudulent schemes—and by extension, the  
8 'wholesale' division fraud—from becoming more widespread; and/or  
9 (c) otherwise enabling IMG to remain in operation and the fraud  
10 to continue." Trustee's Complaint, filed June 16, 2015

11 ("Compl."), at 15:15-19. The complaint goes on:

12 at the time each of the Settlement Transfers was made,  
13 Deepal Wannakuwatte understood that causing those  
14 transfers to be made would inevitably harm IMG's and  
15 Olivehurst's creditors. Wannakuwatte knew that he had  
16 operated a Ponzi scheme, that he had repeatedly  
17 defrauded investors into providing financing for IMG's  
18 functionally non-existent "wholesale" division, and  
19 that IMG's investors would not be repaid when his  
20 scheme ended. Wannakuwatte further knew that  
21 Olivehurst, IMG, and Relyaid were hopelessly insolvent.  
22 Deepal Wannakuwatte knew that causing the Settlement  
23 Transfers would harm investors by both: (a) prolonging  
24 the scheme and (b) reducing the amount of funds  
25 available to repay creditors. Finally, Wannakuwatte  
26 knew that using funds to pay off GECC, rather than  
27 invest in product, constituted a fraud upon the  
28 investors whom had provided funds to Olivehurst.

21 Id. at 16:1-3. The complaint also alleges sufficient ownership  
22 and control by Wannakuwatte over Relyaid, IMG, and Olivehurst to  
23 impute his intent to them.

24 \_\_\_\_\_  
25 5. It is important to note that the verbs, as used in §  
26 548(a)(1)(A), are in the disjunctive; thus, the trustee need  
27 establish only one of the three with respect to the payments to  
28 GECC – that they were made with the actual intent to hinder  
creditors, the actual intent to delay creditors, or the actual  
intent to defraud creditors. In re Stanton, 457 B.R. 80, 93-94  
(Bankr. D. Nev. 2011); In re Roca, 404 B.R. 531, 543-44 (Bankr.  
D. Ariz. 2009).

1 These allegations are more than sufficient to state a claim  
2 under §§ 548 and 550 upon which relief can be granted. To be  
3 clear, there was no indication in either the Boston Trading or  
4 the Sharp Int'l decision that the plaintiff's complaint contained  
5 such allegations. For the reasons stated, the court rejects  
6 GECC's contention that the trustee's claim is nothing more than a  
7 time-barred preference claim.

## 8 II. The Question of Duty

9 Next, GECC contends the complaint cannot stand because "the  
10 Trustee can never plead facts which would create the duty upon  
11 which her fraudulent transfer claim is premised." Mot. at 4:6-7.  
12 The problem with the argument is simple: duty is not an element  
13 of a fraudulent conveyance claim. Thus, there is no requirement  
14 that the plaintiff plead or prove the transferee had any sort of  
15 duty.

16 GECC frames the issue in terms of law other than the law of  
17 fraudulent conveyances:

18 GE Capital did not owe a duty to its borrower and  
19 guarantors beyond any duties expressed in the  
20 underlying Equipment Loan Agreement. . . . A lender's  
21 decision to exercise rights granted by contract cannot  
22 form the basis of a fraudulent transfer claim because  
23 no duty to a guarantor or other creditors is breached  
24 under these circumstances. The Trustee does not and  
25 cannot allege that anything in the Equipment Loan  
26 Agreement created a duty to IMG or its creditors  
27 requiring GE Capital to disclose anything to anyone  
28 about its efforts to collect on the loan. Furthermore,  
even assuming a failure to disclose material facts  
known only to one party, no cause of action lies unless  
there is a fiduciary duty or confidential relationship  
imposing a duty to disclose. The Trustee does not  
allege any duty or confidential relationship which  
required GE Capital to disclose anything to IMG's  
creditors.

28 Mot. at 13:3-5; 13:19-14:5 (citations omitted). The authority

1 GECC cites for these propositions, Sipe v. Countrywide Bank, 690  
2 F. Supp. 2d 1141, 1153 (E.D. Cal. 2010), and Cal. Civ. Code  
3 1710(3), has nothing to do with fraudulent conveyance law.<sup>6</sup>

4 In its reply, GECC seems to back away from its theory that a  
5 breach of duty is an element the trustee must plead and instead  
6 frame the duty issue more in terms of whether GECC acted in good  
7 faith when it took the payments. The court will return to this  
8 aspect of the discussion below.

### 9 III. The Ponzi Scheme Presumption

10 Next, GECC claims the trustee's complaint fails because it  
11 does not "includ[e] specific facts supporting a reasonable  
12 inference that the challenged transfers are connected to a Ponzi  
13 scheme" (Mot. at 14:4-5), and therefore, the Ponzi scheme  
14 presumption of actual fraud does not apply. GECC relies heavily  
15 on the fact that it is not alleged to have been an investor in  
16 the Ponzi scheme. First, the court has already concluded that  
17 the trustee's complaint sufficiently alleges actual fraud on the  
18 part of the transferor to state a claim; thus, application of the  
19 Ponzi scheme presumption is not necessary.

20 However, the court will also deny the motion on the  
21 independent basis that the allegations of the complaint are  
22 sufficient to state a claim based on the Ponzi scheme  
23 presumption. The trustee has cited a number of cases supporting  
24 the proposition that, depending on the connections between the  
25 Ponzi scheme and the payments to the lenders, the presumption may

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26  
27 6. GECC also cites Sharp Int'l, 403 F.3d at 52, n.2, which,  
28 as discussed above, was a fraudulent conveyance case; however,  
GECC's citation is to a section of the opinion concerning a claim  
for aiding and abetting the breach of a fiduciary duty.



1 be applied against commercial lenders who were not investors in  
2 the Ponzi scheme. GECC, on the other hand, cites Klein v. Bd. of  
3 Trs. of the Cal. State Univ. (In re Moriarty), 2014 Bankr. LEXIS  
4 4802 (Bankr. C.D. Cal. 2014). In that case, a couple named  
5 Moriarty made a donation to Cal Poly which Cal Poly agreed to and  
6 did use to purchase a new video scoreboard for its stadium and to  
7 put the name of the couple's business at the top of the  
8 scoreboard. When the couple later filed bankruptcy, the trustee  
9 in their case sued to avoid the transfer under § 544 of the  
10 Bankruptcy Code and California fraudulent transfer law. The  
11 court granted Cal Poly's Rule 12(b)(6) motion - with leave to  
12 amend - because the

13 complaint does not contain facts describing the  
14 Moriarty Ponzi Scheme nor does it contain specific  
15 facts to support a reasonable inference that the  
16 subject transfers were connected to the Moriarty Ponzi  
17 Scheme. Furthermore, Klein's complaint does not allege  
18 sufficient facts to form the basis for a finding that  
19 the subject transfers actually hindered, delayed or  
20 defrauded a creditor of the Debtor or that the Debtor  
21 intended the subject transfers to do so on the date of  
22 the transfer.

23 2014 Bankr. LEXIS 4802, at \*27.

24 The case does not support GECC's position here because,  
25 unlike the trustee in Moriarty, the trustee has alleged  
26 sufficient connections between the Ponzi scheme and the payments  
27 to GECC to state a claim to relief based on the Ponzi scheme  
28 presumption. First, she has made detailed allegations concerning  
the Ponzi scheme itself. She has also alleged IMG routinely used  
the name of consolidated debtor Relyaid (GECC's borrower) in its  
marketing materials to potential investors in the scheme; that  
Wannakuwatte pled guilty and was convicted for his role in the



1 scheme; that a large portion of the loan proceeds from GECC were  
2 deposited into "the primary bank account through which Ponzi  
3 scheme payments to investors were made" (Compl. at 11:16); that  
4 other proceeds went to Wannakuwatte, his spouse, IMG, and another  
5 consolidated entity; that the funds used to make the payments to  
6 GECC came from IMG investors; and that, based on the facts  
7 alleged above, the payments were made in furtherance of the Ponzi  
8 scheme.

#### 9 IV. GECC as a Net Loser

10 GECC next argues that "[t]he Trustee cannot have it both  
11 ways." Mot. at 16:13. "She relies on the Ponzi scheme  
12 presumption while refusing to recognize that the net winner rule  
13 applies. Were the Ponzi scheme presumption applicable, and the  
14 transfers at issue were part of the underlying scheme, thus  
15 giving rise to the presumption, that presumption operates only  
16 against 'net winners.'" Mot. at 16:13-16. (It is undisputed  
17 that the payments made to GECC totaled less than the amount GECC  
18 loaned Relyaid.)

19 This argument improperly conflates the Ponzi scheme  
20 presumption and the "net winner rule."<sup>7</sup> The Ponzi scheme

21 \_\_\_\_\_  
22 7. The presumption is simply stated: "[T]he mere  
23 existence of a Ponzi scheme is sufficient to establish actual  
24 intent to defraud." Donell, 533 F.3d at 770 (citations omitted,  
internal quotation marks omitted). The net winner "rule," more  
accurately called the "netting rule," is simple as well:

25 Amounts transferred by the Ponzi scheme perpetrator to  
26 the investor are netted against the initial amounts  
27 invested by that individual. If the net is positive,  
28 the receiver has established liability, and the court  
then determines the actual amount of liability, which  
may or may not be equal to the net gain, depending on  
factors such as whether transfers were made within the  
limitations period or whether the investor lacked good

1 presumption comes into play only with respect to the transferor's  
2 intent in making the challenged transfers; that is, it is  
3 relevant solely to the trustee's case-in-chief for avoidance of  
4 an actual fraudulent conveyance. The "net winner rule," in  
5 contrast, concerns only the issue whether the recipient of the  
6 transfer gave reasonably equivalent value to the transferor in  
7 exchange for the transfer. Thus, it comes into play solely in  
8 connection with (1) the trustee's case-in-chief for avoidance of  
9 a constructive fraudulent conveyance under § 548(a)(1)(B) and/or  
10 the related state law provision, and (2) the "for value" portion  
11 of the transferee's "good faith and for value" defense under §  
12 548(c) and/or related state law provisions. The "net winner"  
13 rule is really nothing more than the recognition that a Ponzi  
14 scheme investor has a restitution claim against the debtor for  
15 the amounts the investor paid into the scheme, the satisfaction  
16 of which constitutes reasonably equivalent value for the payments  
17 the investor received back before the scheme collapsed. This  
18 brings the court to GECC's final argument.

#### 19 V. The Issue of Good Faith

20 GECC's final argument is that "[a]ssuming the Trustee  
21 adequately pled a fraudulent transfer claim, the complaint must  
22 be dismissed as GE Capital is a good faith creditor which took  
23 for value." Mot. at 18:17-18. The problem here is that GECC's

24 \_\_\_\_\_  
25 faith. If the net is negative, the good faith investor  
26 is not liable because payments received in amounts less  
27 than the initial investment, being payments against the  
28 good faith losing investor's as-yet unsatisfied  
restitution claim against the Ponzi scheme perpetrator,  
are not avoidable within the meaning of UFTA.

Id. at 771.

1 good faith is a component of its good faith and for value  
2 defense, which, in the context of an actual fraudulent  
3 conveyance, is an affirmative defense. "It is not incumbent on  
4 the plaintiffs to plead lack of good faith on defendants' part  
5 because lack of good faith is not an element of a plaintiff's  
6 claim under Section 548(a)(1)[(A)]." Bayou Superfund, LLC v. WAM  
7 Long/Short Fund II, L.P. (In re Bayou Grp., LLC), 362 B.R. 624,  
8 639 (Bankr. S.D.N.Y. 2007); see also Brandt v. KLC Fin., Inc. (In  
9 re Equip. Acquisition Res., Inc.), 481 B.R. 422, 429 (Bankr. N.D.  
10 Ill. 2012); Picard v. Merkin (In re Bernard L. Madoff Inv. Sec.  
11 LLC), 440 B.R. 243, 256 (Bankr. S.D.N.Y. 2010).

12       Whether GECC acted in good faith is a question of fact that  
13 would ordinarily not be appropriately resolved on a motion to  
14 dismiss. "The element of good faith under section 548(c) of the  
15 Code, bearing upon a transferee's motivations, is indisputably a  
16 factual question that may not be determined on the face of [a]  
17 complaint." In re Bernard L. Madoff Inv. Sec., 440 B.R. at 256.  
18 However, GECC contends that "based on the allegations in the  
19 Complaint viewed in the light most favorable to the Trustee, GE  
20 Capital satisfies its burden to establish good faith under  
21 section 548(c)." Mot. at 19:16-18.

22       "Dismissal under Rule 12(b)(6) on the basis of an  
23 affirmative defense is proper only if the defendant shows some  
24 obvious bar to securing relief on the face of the complaint."  
25 Asarco, LLC v. Union Pac. R.R. Co., 765 F.3d 999, 1004 (9th Cir.  
26 2014) (citations omitted). On the other hand, "[i]f, from the  
27 allegations of the complaint as well as any judicially noticeable  
28 materials, an asserted defense raises disputed issues of fact,

1 dismissal under Rule 12(b)(6) is improper." Id. (citation  
2 omitted). In GECC's view, the complaint fails because it does  
3 not allege GECC knew of the Ponzi scheme and because the "red  
4 flags" alleged in the complaint "do not come close to suggesting  
5 knowing or reckless participation" in the Ponzi scheme. Mot. at  
6 19:19-20. The argument fails for two reasons. First, as  
7 discussed below, "knowing or reckless participation" in the Ponzi  
8 scheme is not the appropriate standard for the good faith test in  
9 this circuit. GECC's reliance in its motion on Sharp Int'l and  
10 in its reply on B.E.L.T., Inc. v. Wachovia Corp., 403 F.3d 474  
11 (7<sup>th</sup> Cir. 2005), is misplaced. Both cases were decided under  
12 state fraudulent transfer laws (New York and Illinois,  
13 respectively), and both applied a standard for assessing good  
14 faith that is not the standard in the Ninth Circuit under §  
15 548(c). Second, the court is not inclined to determine the  
16 factual issues attendant to a good faith defense on a Rule  
17 12(b)(6) motion.

18 "[G]ood faith is not susceptible of precise definition" (In  
19 re Agricultural Research & Tech. Group, Inc., 916 F.2d 528, 536  
20 (9th Cir. 1990) ("Agretech") (citation omitted, internal  
21 quotation marks omitted)), and the analysis, being intensely  
22 factual, must be made on a case-by-case basis. Meeks v. Red  
23 River Entm't (In re Armstrong), 285 F.3d 1092, 1096 (8th Cir.  
24 2002). Nevertheless, the courts have provided guidance. Thus,  
25 "courts look to what the transferee objectively 'knew or should  
26 have known' in questions of good faith, rather than examining  
27 what the transferee actually knew from a subjective standpoint."  
28 Agretech, 916 F.2d at 535-56. Facts that should have put a

1 reasonable person on notice of a fraudulent scheme, which would  
 2 have been discovered through a diligent inquiry, constitute bad  
 3 faith in receiving fraudulent transfers. Id. at 539; see also  
 4 Woods & Erickson, LLP v. Leonard (In re AVI, Inc.), 389 B.R. 721,  
 5 736 (9th Cir. BAP 2008) [looking to what the transferee  
 6 objectively "knew or should have known," not what he knew from a  
 7 subjective standpoint]; Plotkin, 199 B.R. 709 at 720 ["Facts  
 8 sufficient to warrant a finding of inquiry notice are . . .  
 9 sufficient to defeat the good faith that is essential to the §  
 10 548(c) safe harbor."].<sup>8</sup>

11 GECC's framing of the issue in its reply crystallizes the  
 12 distinction between its view of the applicable good faith  
 13 standard and the one just described, which applies in the Ninth  
 14 Circuit. In GECC's view, "'bad faith' is encouraging, aiding,  
 15 abetting, or concealing a further fraud, embezzlement or Ponzi  
 16 scheme . . . ." Reply at 2:27. As just discussed, the standard  
 17 in this circuit for a transferee's good faith defense is not  
 18 limited to someone who "encouraged, aided, abetted, or concealed"  
 19 a fraud.

20 / / /

21 \_\_\_\_\_  
 22 8. Other circuits apply the same or a similar standard.  
 23 Thus, "[a] transferee does not act in good faith when he has  
 24 sufficient [actual] knowledge to place him on inquiry notice of  
 25 the debtor's possible insolvency." Goldman v. Capital City  
 26 Mortg. Corp. (In re Nieves), 648 F.3d 232, 238 (4th Cir. 2011)  
 27 (citation omitted). "[G]ood faith under § 548(c) should be  
 28 measured objectively and . . . if the circumstances would place a  
 reasonable person on inquiry of a debtor's fraudulent purpose,  
 and a diligent inquiry would have discovered the fraudulent  
 purpose, then the transfer is fraudulent." Jobin, 84 F.3d at  
 1338 [10th Circuit]. "[T]he recipient of a voidable transfer may  
 lack good faith if he possessed enough knowledge of the events to  
 induce a reasonable person to investigate." Bonded Fin. Servs.  
v. European Am. Bank, 838 F.2d 890, 897-98 (7th Cir. 1988).

1 For the reasons stated, the court concludes the plaintiff's  
2 complaint contains factual allegations sufficient to state a  
3 claim to relief under § 548(a)(1)(A), and the motion will be  
4 denied. The court will issue a minute order.

5 Dated: September 10, 2015



ROBERT S. BARDWIL

United States Bankruptcy Judge

**Instructions to Clerk of Court  
Service List – Not Part of Order/Judgment**

The Clerk of Court is instructed to send the Order/Judgment or other court generated document transmitted herewith to the parties below. The Clerk of Court will send the Order via the BNC.

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